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REGULATORY FLEXIBILITY COMMITTEE

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MEETING MINUTES

Meeting Date: November 24, 1998
Meeting Time: 10:00 A.M.
Meeting Place: State House, 200 W. Washington St. ,
Senate Chambers
Meeting City: Indianapolis, Indiana
Meeting Number: 1

Members Present: Sen. Morris Mills, Co-Chair; Sen. Beverly Gard; Sen. Glenn Howard; Sen. Timothy Lanane; Sen. James Lewis; Sen. David Long; Sen. James Merritt; Sen. Becky Skillman; Sen. Thomas Weatherwax; Rep. James Bottorff, Co-Chair; Rep. Robert Behning; Rep. Richard Bodiker; Rep. David Crooks; Rep. Susan Crosby; Rep. David Frizzell; Rep. Jack Lutz; Rep. Edmund Mahern.

Members Absent: Rep. James Buck; Rep. Brian Hasler; Rep. Bruce Munson; Rep. Paul Robertson; Rep. David Yount.

CALL TO ORDER AND OPENING REMARKS

Co-Chair Senator Mills opened the meeting at approximately 10:45 am. He introduced William McCarty, Chairman of the Indiana Utility Regulatory Commission (IURC).

DISCUSSION OF ENERGY RELATED ISSUES

William McCarty, Chairman, Indiana Utility Regulatory Commission, highlighted Indiana's position as a relatively low-cost energy state compared with neighboring states and the country as a whole¹. He noted that Purdue University's State Utility Forecasting Group has shown that the real cost of electricity has actually declined since 1987. He added that Indiana does not face the problems of stranded costs that electrical utilities in other states are experiencing. Mr. McCarty then outlined three other significant issues:

¹A copy of McCarty's outline and other materials from the morning presentation on energy are on file at the Legislative Information Center, Room 230, State House, Indianapolis, Indiana. The telephone number of the Legislative Information Center is (317) 232-9856, and the mailing address is 200 West Washington Street, Suite 301, Indianapolis, Indiana 46204-2789.

- The use of Alternative Regulatory Plans (ARPs)² and expedited filing procedures have helped to streamline the regulatory process. 30-day filing procedures may now be used for non-controversial filings and rule changes instead of the traditional formal hearings. About 700 of these expedited filings were completed in 1997.
- The proposed merger of American Electric Power (AEP) and Central and Southwest Corporation (CSW) would create the largest investor owned utility in the country. The impact of such a merger on competition and reliability must be investigated. A study by the Federal Energy Regulatory Commission (FERC) is currently examining the implications.
- The creation of subsidiary communication firms of power companies would add a new dimension to open the local telecommunication market. However, such new enterprises also raise serious issues of cross-subsidization. In March 1998, AEP's requested approval of AEP Communications and the Southern Indiana Gas & Electric Company's parent corporation SIGECORP followed suit in May with SIGECOM. Both of these applications were approved by the IURC; SIGECOM was conditional.

Natural Gas Industry: Natural gas rates for residential customers in Indiana are also below the national average. Mr. McCarty addressed three key developments in the gas industry:

- The recent court review of the formation of ProLiance in which contracts were voided on the basis that they were formed prior to IURC approval.
- NIPSCO's development of an ARP which included the unbundling of gas supply to consumers. Although this was an important step towards customer choice, the response from residential users has been slow. However, much has been learned about how to provide effective consumer education on these new issues.
- NIPSCO's acquisition of the Massachusetts utility Bay State Gas Company.

Retail Competition: Most states with relatively high electric costs have begun restructuring, although the overall level of residential participation in retail competition has been low. Restructuring and mandatory residential rate cuts were approved in Illinois in December 1997. It is not yet clear if similar legislation will be successful in Ohio. Mr. McCarty told the Committee members that tax restructuring should precede restructuring of the utility industry itself, as was done in Iowa. However, the IURC is skeptical of major restructuring legislation passing in the upcoming session.

Mr. McCarty acknowledged the potential for energy "slamming", or the unauthorized switching of a customers service provider, in a restructured marketplace. He stated that the IURC would need to prepare for deregulation by establishing codes of conduct and rules for affiliates of utilities. Senator Mills pointed out that there may be confusion if unregulated affiliates of a regulated utilities were allowed to build additional generating capacity.

Wholesale Competition: Wholesale competition has been influenced in California by Independent System Operator (ISO) and Power Exchange (PX). The ISO and PX maintained stable prices in June 1998 below the rate \$0.03/kWh. This is in sharp contrast to the price spikes that occurred in the Midwest in late June, 1998.

The FERC approved a proposed ISO for five Midwestern states in September which presently includes utilities serving central and southern Indiana, most of Illinois, parts of Kentucky and West Virginia, and a small portion of Ohio. Senator Weatherwax expressed his concern that, given the price spiking

²SEA 637 became law in April 1995 (I.C. 8-1-2.5) and allows alternative regulation plans to be used instead of the traditional cost-based regulation.

mentioned earlier in the presentation, this ISO may not be large enough to ensure stability.

On June 22, 1998, electricity prices in the Midwest spiked briefly from a level of \$0.03/kWh to as high as \$7.50/kWh. This price increase was caused partially by unseasonably high temperatures and also because a significant amount of generating capacity was offline. The FERC is also currently investigating charges of price manipulation. Mr. McCarty stated that a regional ISO would have helped to maintain price stability and reliability.

Future Considerations for Policy Makers: Mr. McCarty posed several questions that the IURC may need to consider in the near future, including:

- If Indiana is in need of extra generating capacity.
- If additional capacity is needed, whether the application process for adding new peaking units should be expedited.
- Exploring the effects of restructuring beyond the impact on the average consumer. In particular, the nine Indiana counties which could be greatly affected by potential plant closings. Such reductions in the tax base could have extremely negative fiscal impacts in some communities.
- Policy questions, such as how to avoid a dual tax system in which Indiana utilities are taxed differently than out of state firms on the sale of power.

Senator Mills offered that an increasing reliance on natural gas may not be an adequate strategy to pursue, and suggested further examination of the long-run effects. Senator Lanane inquired about the impact on residential users in states that have already restructured their power markets. Mr. McCarty replied that the impacts have been minimal.

Patrick Bennett, Indiana Builders Association (IBA), spoke briefly about his organization's concern with maintaining affordability for new home buyers in Indiana. He then introduced Dave Compton, chair of the IBA's land development committee. Mr. Compton explained that when land is developed, power companies help to cover the cost of building infrastructure by extending credit based on the expected revenue from the development over the next thirty months. However, if this credit were eliminated under deregulation, these costs would be passed along to the consumer. He also requested that the Committee **pursue** deregulation not only at the wholesale level, but at the retail level as well.

Jerry Polk, Citizens Action Coalition (CAC), applauded recent developments in the area of customer choice, such as the Northern Indiana Public Services Company's (NIPSCO's) unbundling of natural gas supply and a new billing plan offered by Indianapolis Power & Light. (IPL). However, he strongly cautioning against a "flash cut" to competition. He cited the Consumers Union's projections that for every \$1-2 savings in energy generation, an additional \$3-5 in transaction costs would be created with increased competition. He added that the American Gas Association has also predicted price increases in the short term under deregulation.

Mr. Polk believes that technological advances will continue to lower costs to consumers even without major restructuring. He warned without regulation, companies would "lose interest" in serving residential users. Mr. Polk suggested that the public interest component of SEA 637 be expanded to increase the number of parties that may petition for alternative regulation (only utilities currently may do so). He addressed Mr. McCarty's suggestions of streamlining in the Certificate of Territorial Authority (CTA) granting process, stating that this may not be necessary given the provisions of SEA 637.

Ed Simcox, President, Indiana Electric Association (IEA), stated that his organization would not present a proposal to the legislature during this session. He outlined the IEA's agenda, which includes communicating with the leaders of municipal utilities and rural cooperatives to discuss restructuring and develop consensus agreement. Mr. Simcox stated that three major concerns of the utilities are system reliability, environmental issues, and Y2K compliance.

DISCUSSION OF TELECOMMUNICATION ISSUES

William McCarty, Chairman, Indiana Utility Regulatory Commission, emphasized that in the area of telecommunications, the IURC is evolving from a regulator to a referee-type role.³ He outlined the federal Telecommunications Act of 1996 (TA96). Under TA96, the IURC has helped to facilitate the transition to competition in the local exchange market in four important ways:

- The CTA for the resale of long distance petitioning process was streamlined from a formal hearing to the submission of a form.
- The IURC has granted 103 CTAs to new local exchange market entrants. 79 of these were granted with resale authority, and 24 are new entrants with facilities-based authority.
- The IURC approved 73 voluntarily interconnection agreements in 1997.
- In October 1997, Ameritech Indiana's wholesale tariff was discounted by 21% for new entrants.

While accelerating administrative processing times and reducing regulation, the IURC must maintain its statutory commitment to universal service. Federal programs have been implemented to help ensure this goal.

Mr. McCarty identified several projects that the IURC would be working on:

- Developing a series of orders on affordability, comparability between urban and rural service, and compliance of rate rebalancing with TA96.
- Streamlining the tariff change process.
- Surveying utilities to assess the state of Y2K readiness in Indiana.
- Assessing the impact of mergers and addressing service quality standards.

Several obstacles to competition were listed by Mr. McCarty. Litigation, confusing federal regulation, possible understaffing of the IURC, and the workload of interconnection complaints are important factors. Disputes between firms in interconnection agreements are growing rapidly, contributing to the shift towards a referee-type role for the IURC (mechanisms to resolve such disputes are being developed).

The Commission's lack of enforcement authority was also identified as an obstacle to competition, and this issue received the most attention throughout the afternoon telecommunications session. The IURC cannot levy fines-- currently, the only recourse available is revocation of an offender's license of operation. Mr. McCarty assured the Committee that fines would not be employed as a revenue source, but simply to encourage compliance. Rep Bottorff inquired as to what level of fines or penalties would be appropriate. Mr. McCarty responded that a maximum fine of \$25,000 per offense would be reasonable. However, he added that the level of fines imposed should depend on the size of the firm.

Other changes in Indiana's telecommunications industry were briefly mentioned, including the 1998 passage of HEA 1297 (prohibiting slamming and cramming). Extended Area Service (EAS) is also being explored-- in June 1998, the Commission approved Ameritech's plan to make calls within its Lake County exchanges toll-free.

Jerry Polk, Citizens Action Coalition (CAC), spoke in favor of increased IURC staffing and a range of "refereeing" powers for the Commission. Senator Mills asked how the roles of the IURC and the Office of the Utility Consumer Counselor are being redefined. Mr. Polk stated that the OUCC should take on some of the state Attorney General's current responsibilities. Mr. McCarty added that the OUCC will have to conduct more consumer education given greater choice available in the telecommunications market.

³Mr. McCarty's outline and other materials from the afternoon presentation on the telecommunications industry are on file at the Legislative Information Center (see footnote 1).

Joan Campion, MCI/WorldCom, explained that since Ameritech has not entered the long distance market as encouraged by TA96, it has been able to maintain its local monopoly. She expressed great concern over the proposed SBC/Ameritech merger as further stifling local exchange competition in Indiana. In response to the paradigm shift from consumer protection to refereeing disputes between firms, Ms. Campion believes the IURC should establish the interconnection prices and access charges for long distance companies. Ms. Campion also mentioned that enforcement legislation was recently passed in Illinois and Wisconsin.

Michael Tye, AT&T, testified mainly on the status of the local exchange market and how the IURC can advance competition. Since the passage of TA96, the number of access lines owned by Ameritech-Indiana has grown by 149,000 access lines, while lines owned by new competitors increased by only 14,000. Mr. Tye believes this is evidence that the incentives for competition in TA96 are not sufficient, and should be supplemented by legislation in Indiana to encourage opening of the local market.

Mr. Tye also believes that the sale of Ameritech to SBC would retard competition. With this merger, Indiana consumers would effectively be subsidizing competitive ventures elsewhere in the US. Mr. Tye also addressed the invisible cost hidden in long distance rates which is attributable to access charges. He stated that Ameritech charges about 2 cents per minute, or 800% above cost. Mr. Tye suggested that the IURC be given enforcement powers and the power to reduce access rates to cost, which would return approximately \$60 million to Indiana consumers.

William F. Kreutz, State Director, External Affairs, GTE, noted that there have been new entrants in the local exchange market that GTE serves. In July, US Exchange had only 158 customers statewide, but by October this number had grown to 1,300. Mr. Kreutz stated that GTE's proposed merger with Bell Atlantic would not have the same implications as the proposed SBC/Ameritech deal. Senator Lanane asked about the powers of state institutions regarding the investigation and approval of such mergers.

Mark Titus, Vice President (Midwest Region), Time Warner Telecom, testified that Time Warner Telecom, a new entrant in the Indianapolis market, has experienced conflicts with Ameritech-Indiana. Time Warner has filed complaints with the IURC, but Mr. Titus believes that insufficient staffing has slowed the IURC's response. Mr. Titus proposed that:

- The Commission could expedite dispute mediation through alternative methods such as a binding 24-hour negotiating period.
- Providing firms with the ability to deal with IURC even if they have a dispute before the Commission (currently not an option)
- The IURC should hire adequate staff to handle telecommunication issues. Mr. Titus stated that in other states, the number of regulatory staff members handling telecommunication issues is significantly greater than in Indiana. As examples, Mr. Titus indicated that there were 139 such employees in Ohio, 69 in Illinois, and between 20 and 30 in Wisconsin. In contrast, there are only 7 or 8 similar positions in Indiana.

ADJOURNMENT

Co-Chair Senator Mills spoke briefly and adjourned the Committee around 3:15 p.m.